NACHA Quarterly Rulemaking Update

August 9, 2018

Amy Morris

Senior Director, ACH Network Rules - NACHA

Agenda

- RFCs, RFCs, and RFCs!!
  - Same Day ACH Expansion
  - ACH Message Entries
  - Risk Management and Audit Topics

Request for Comment

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Same Day ACH Expansion

REQUEST FOR COMMENT

Background

- Request For Comment and Request for Information distributed December 1, 2017
  - RFC closed January 26

- 211 Parties responded to RFC
  - 159 financial institutions (143 ODFIs)
  - 18 Third-Party Service Providers
  - 10 RPAs
  - 2 ACH Operators
  - 7 financial institution associations
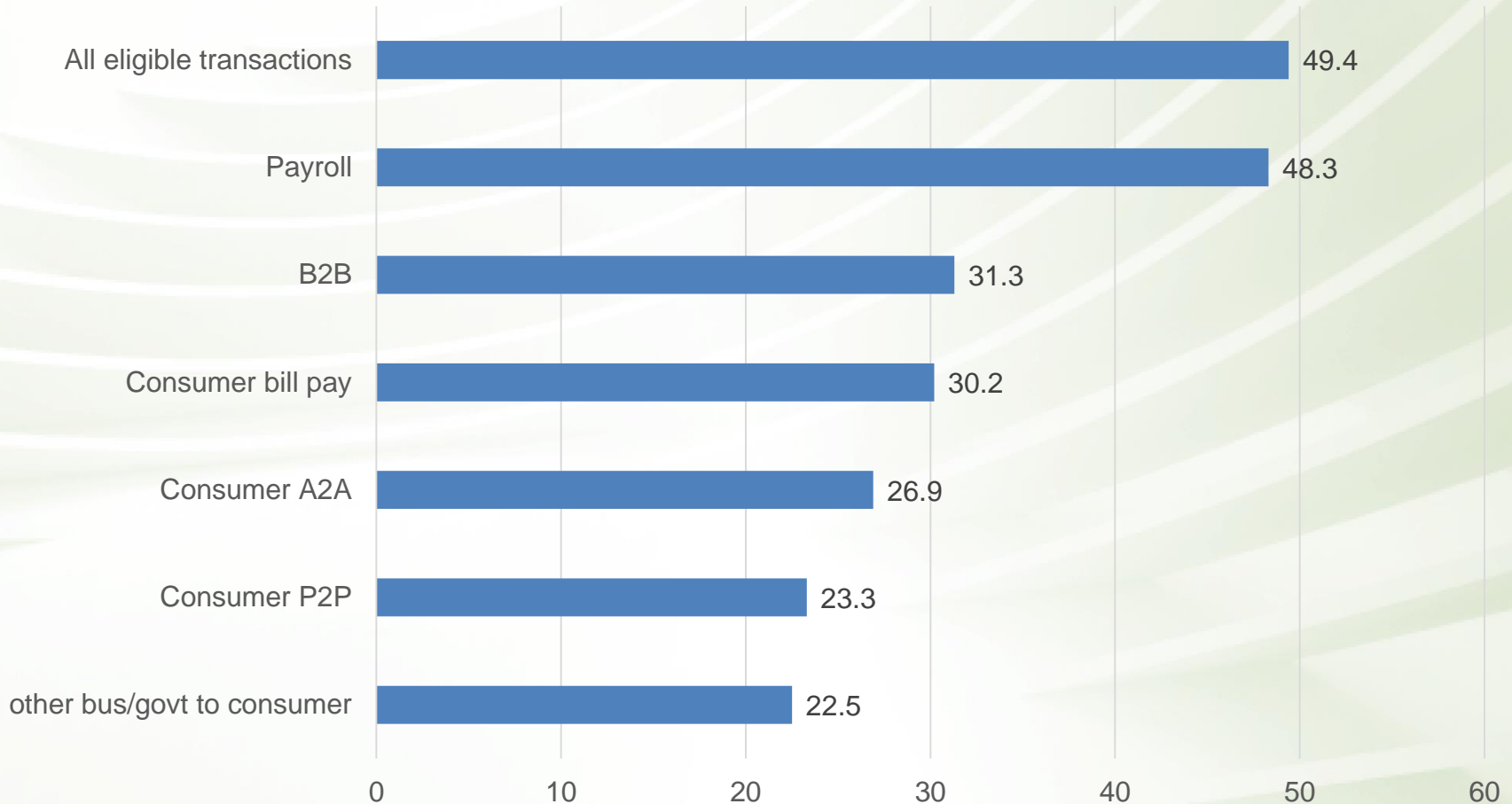 - 14 corporate end-users and associations

Summary

- The RFC covered three topics for expansion:
  - Create a third Same Day ACH processing window that expands Same Day ACH availability
  - Increase the Same Day ACH dollar limit to $100,000 per transaction
  - Establish additional funds availability standards for ACH credits
- The responses to the RFC indicate support for expanding the capabilities of Same Day ACH
  - ACH end-users want expanded hours and higher dollar limits
  - Financial institutions generally support a third processing window
    - The very largest banks, even those in the Eastern Time Zone, support a third processing window (75% indicated "yes," and 25% indicated "don't know")
    - In the Mountain and Western Time Zones, FIs more strongly support expanded hours
    - Some smaller FIs, and many that are in the Eastern Time Zone, are less supportive
  - Majority of respondents support moving forward.
    - Some respondents expressed the desire for certainty regarding the Federal Reserve's decision on settlement and Fedwire services
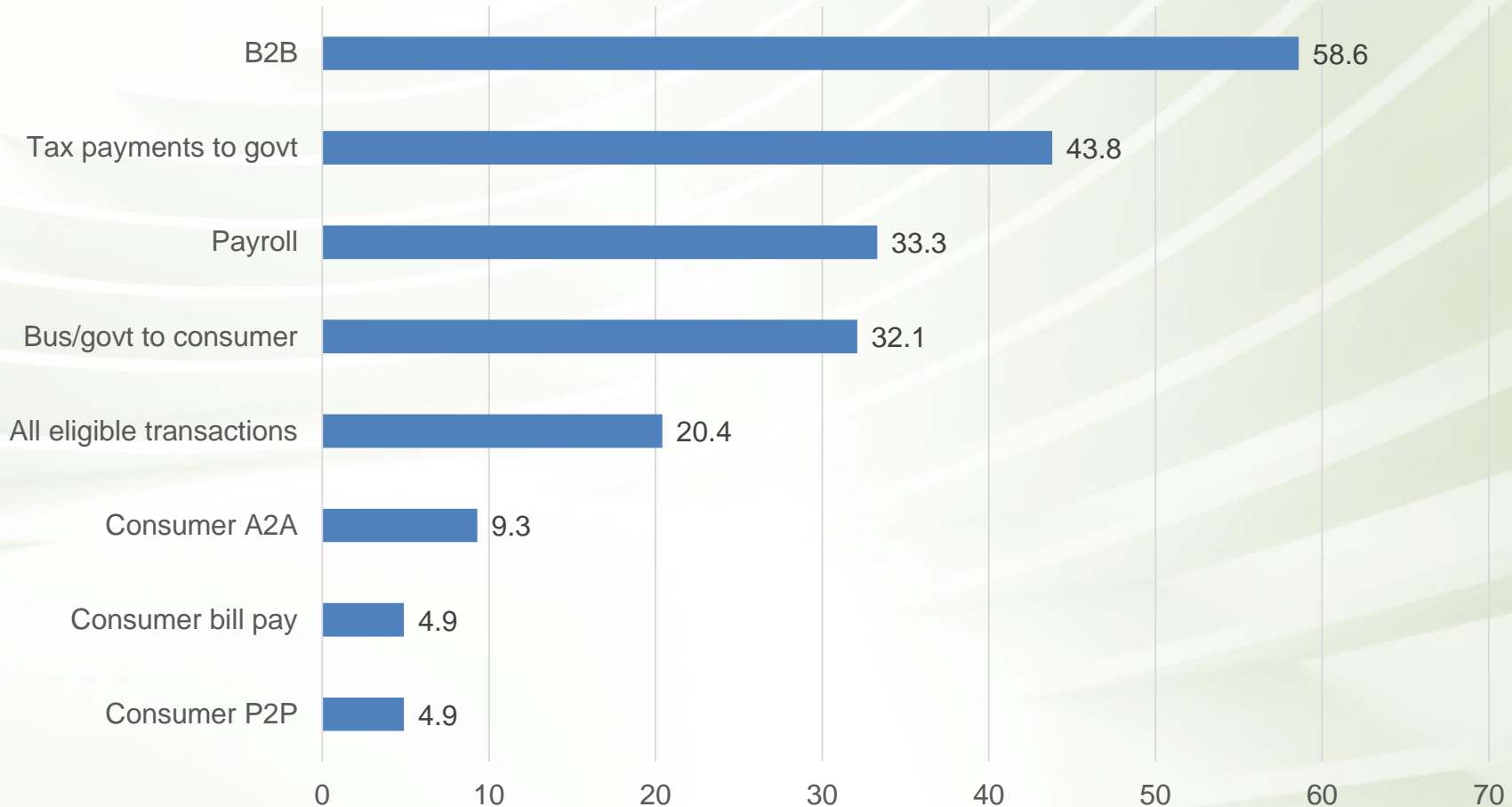
Summary

- Possible modifications that would ease implementation
  - Providing enough time for end-of-day activities, and not impacting 9 p.m. re-opening of Fedwire
    - Moving times of all activities back
  - Deferring the effective date into 2020
  - Reviewing funds availability requirements for 1:00pm in the proposal
- The effective date of the new SDA window would be contingent upon receiving timely approval by the Federal Reserve Board of Governors of changes to Fed services necessary to support it
  - Likely includes a public comment process by the Fed Board on changes to the Fed's SDA service and changes to the Fed's NSS service
  - Similar to the original SDA ballot and rule, if timely approval is not received, then the effective date of the new SDA window would be extended to allow a sufficient implementation period from approval

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What types of transactions would be used in a third SDA window

Category	Value
All eligible transactions	49.4
Payroll	48.3
B2B	31.3
Consumer bill pay	30.2
Consumer A2A	26.9
Consumer P2P	23.3
other bus/govt to consumer	22.5

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What types of transactions would be used with a higher per-transaction dollar limit of $100,000

Transaction Type	Value
B2B	58.6
Tax payments to govt	43.8
Payroll	33.3
Bus/govt to consumer	32.1
All eligible transactions	20.4
Consumer A2A	9.3
Consumer bill pay	4.9
Consumer P2P	4.9

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Which types of SDA transactions should have the per-transaction dollar limit raised?

Bar chart:

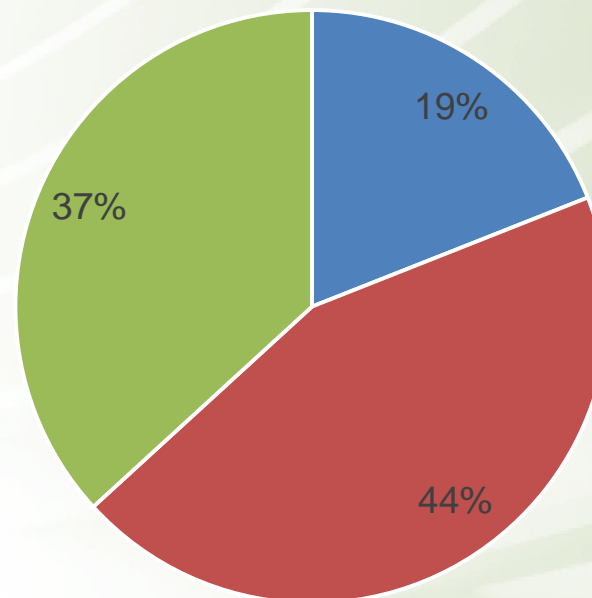| Category	Value
All SDA entries	47.9
Credit entries only	17.8
B2B entries only	17.2
Specific SEC codes	12.9
Specific windows	5.5
Consumer entries only	0.6
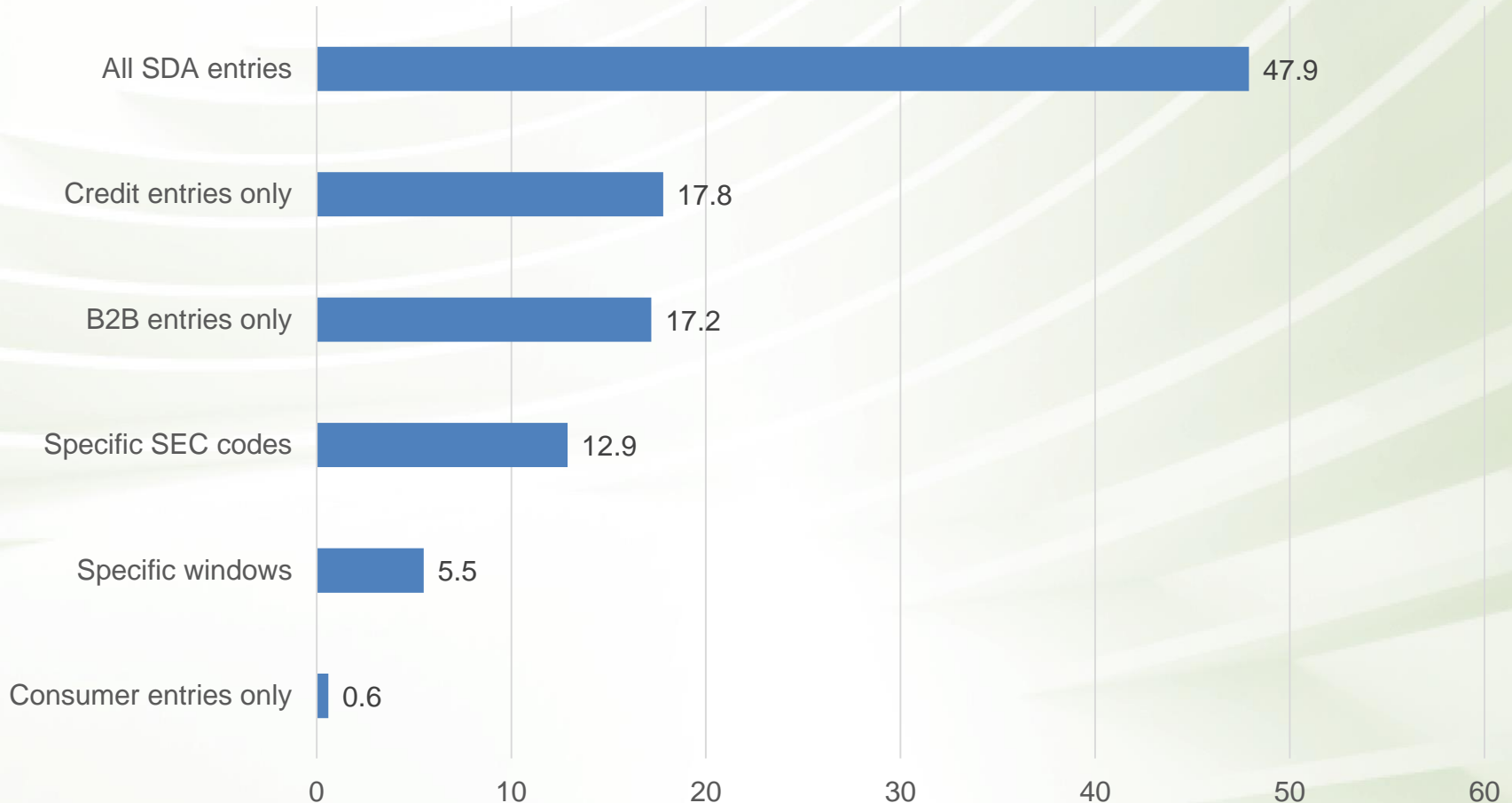
Returns

Do you currently send returns in the returns-only window (4 PM ET submission cut-off)?
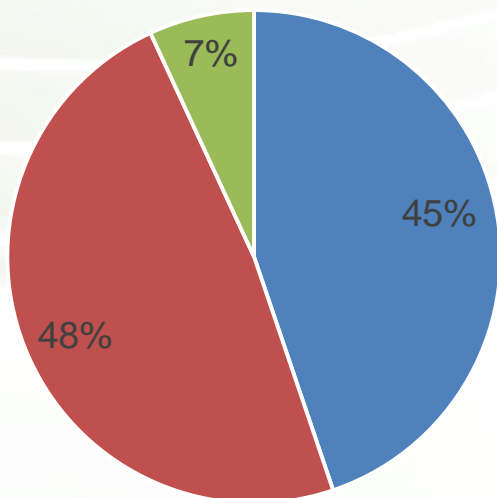
If no, would you in a third, later SDA window?

45%
48%
7%

■ yes ■ no ■ don't know

19%
37%
44%

■ yes ■ no ■ don't know

Next Steps

- Staff and Rules and Operations Committee are working towards modifying the proposals for balloting in late 3Q18
  - Three separate ballots

DFI to DFI Messaging

REQUEST FOR COMMENT

ACH Message Entries

- March 12, 2018 NACHA issued a Request for Comment to generate feedback on proposed rules to use the ACH Network for a new, ubiquitous capability to exchange non-monetary messages between financial institutions
  - referred to in a 2017 Request for Information as "DFI to DFI Messaging"
- Currently, requests and responses for various types of ACH-related documents and other information related to ACH transactions are handled outside of the ACH Network via manual processes

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ACH Message Entries - Proposal at a Glance

- Financial Institutions would use new non-monetary ACH Message Entries with a new SEC Code of "MSG," and supporting Addenda Records, as messages and responses to request and provide various types of information related to ACH transactions
  - Record of Authorization
  - Source Document (converted check) copy
  - Written Statement of Unauthorized Debit copy
  - ODFI-requested returns
  - Additional information related to an Originator
  - Trace Request
  - Other
- Financial institutions receiving these messages also would respond via Message Entries, also using the new MSG SEC Code and Addenda Records inclusive of information to tie the response to the original request

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Background

- Request For Comment closed on April 27, 2018

- 99 respondents to the RFC, includes:
  - 76 Financial Institutions
  - 8 Third-Party Service Providers
  - 9 RPAs
  - 2 ACH Operators
  - 3 Software Providers

Financial institution respondent demographics

Asset Size

Pie chart segments:
- 16% — < $500M
- 34% — $500M - $5B
- 13% — $5B - $25B
- 14% — $25B - $100B
- 23% — >$100B
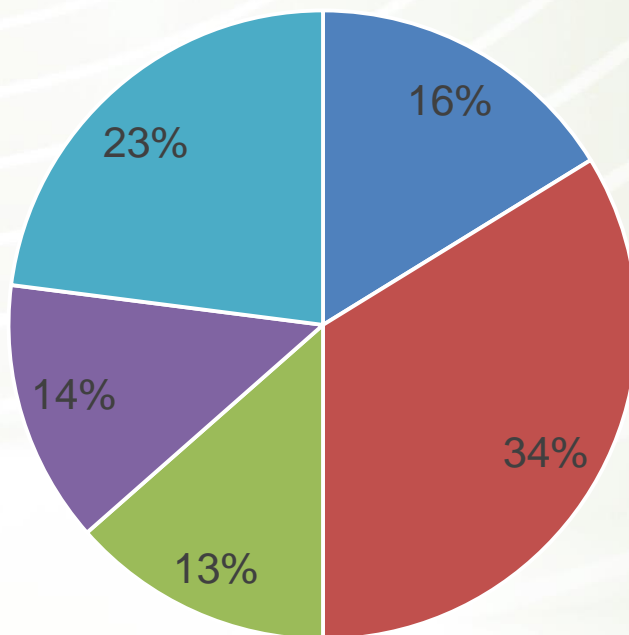
Legend: ■ < $500M   ■ $500M - $5B   ■ $5B - $25B   ■ $25B - $100B   ■ >$100B

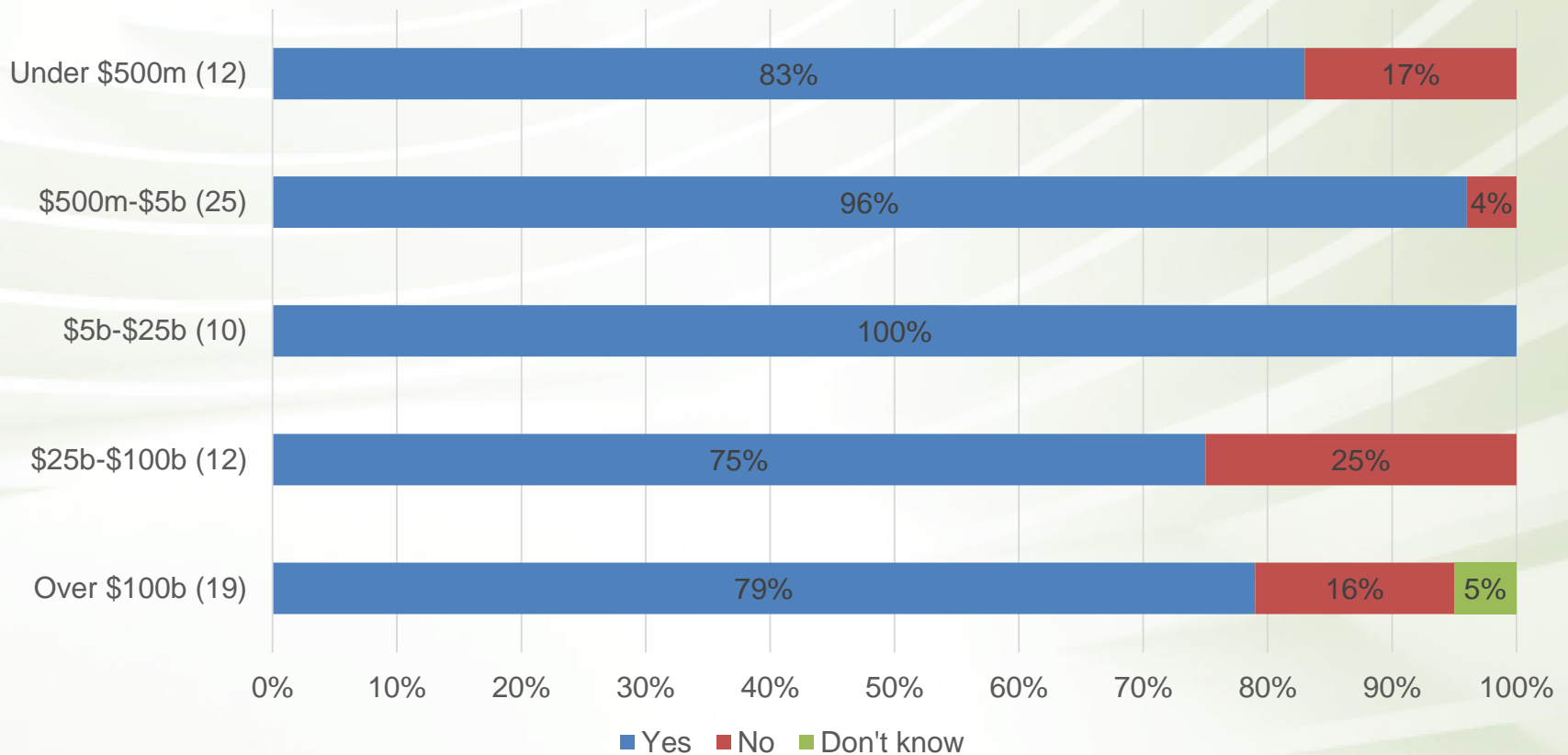NACHA
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Responses - Concept

- Organization generally agrees with establishing ACH Message Entries as described?
  - 86% Yes
  - 10% No
  - 4% Don't Know

- Mandatory usage for requests and responses?
  - 88% Yes
  - 6% No
  - 4% Don't Know

Support for Concept by FI Asset Size

Concept Support

Category	Yes	No	Don't know
Under $500m (12)	83%	17%	
$500m-$5b (25)	96%	4%	
$5b-$25b (10)	100%		
$25b-$100b (12)	75%	25%	
Over $100b (19)	79%	16%	5%

Legend: ■ Yes ■ No ■ Don't know

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Support for use cases

Use case	Percentage
Record of Authorization	90%
Source Doc copy	89%
WSUD copy	90%
ODFI requested return	88%
Originator Info request	86%
Trace request	88%

Support for use cases

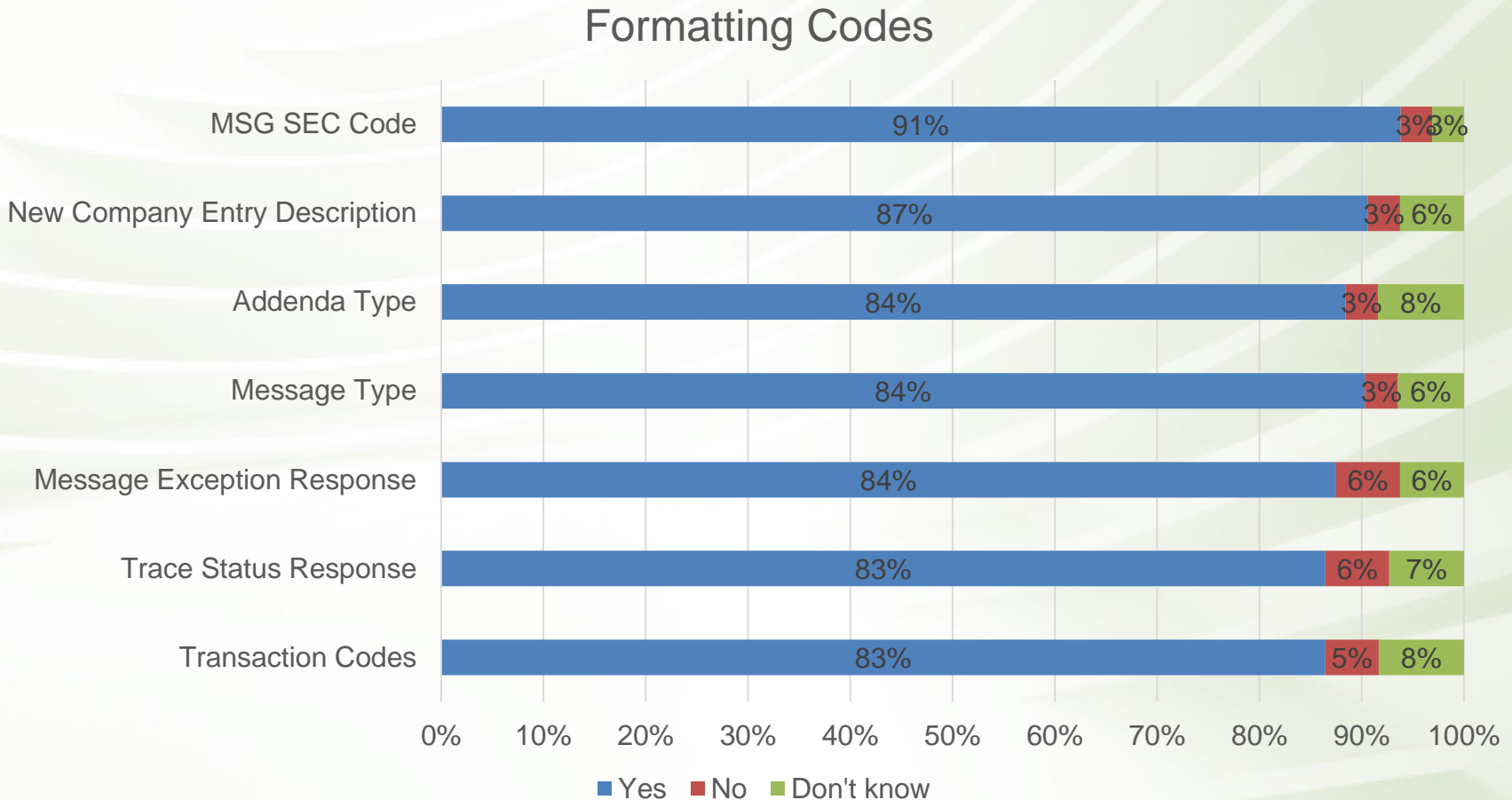| Use Case	Percentage
Record of Authorization - Ten Banking Days (no change from current Rules)	92%
Source Document (Converted Check Copy) -Ten Banking Days (no change from current Rules)	92%
WSUD Copy - Ten Banking Days (no change from current Rules)	91%
ODFI Requested Return (no defined timeframe)	65%
Originator Information - Two Banking Days (new)	67%
Trace Request – Two Banking Days (new)	74%

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Rating Benefits

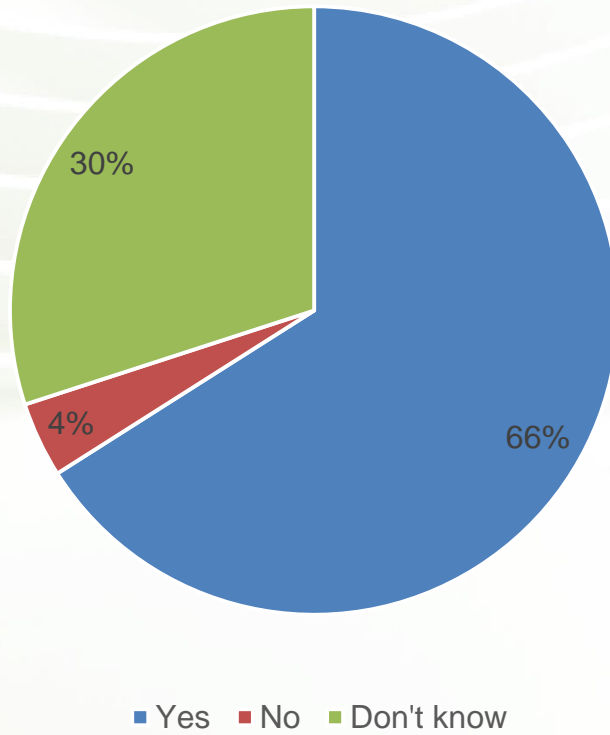| On a scale of 1-5 (with "1" representing no benefit, and "5" indicating extensive benefit), please rate the significance of the anticipated benefits of the message entry proposal:						
	1 = No benefit	2 = Minor benefit	3 = Moderate benefit	4 = Large benefit	5 = Extensive benefit	Don't know
Increase automation of ACH exception processing	4%	10%	30%	27%	28%	1%
Increase the security of potential sensitive information	2%	6%	18%	29%	35%	11%
Provide a known and defined timeframe of receipt and traceability	2%	3%	13%	34%	46%	1%
The ability to pass requests downstream	9%	6%	21%	24%	30%	11%
Acceptance by regulators and auditors	1%	3%	23%	26%	34%	14%
Mandatory response, whether negative or positive	3%	3%	14%	33%	44%	1%

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Support for proposed new codes for formatting Message Entries

Formatting Codes

	Yes	No	Don't know
MSG SEC Code	91%	3%	3%
New Company Entry Description	87%	3%	6%
Addenda Type	84%	3%	8%
Message Type	84%	3%	6%
Message Exception Response	84%	6%	6%
Trace Status Response	83%	6%	7%
Transaction Codes	83%	5%	8%

■ Yes ■ No ■ Don't know

Shared document repository

Agree with the use?

30%

4%

66%

■ Yes ■ No ■ Don't know

Methods to access:

80%	
70%	
60%	
50%	
40%	
30%	
20%	
10%	
0%	

API Internally Supplied UI Vendor Supplied UI other

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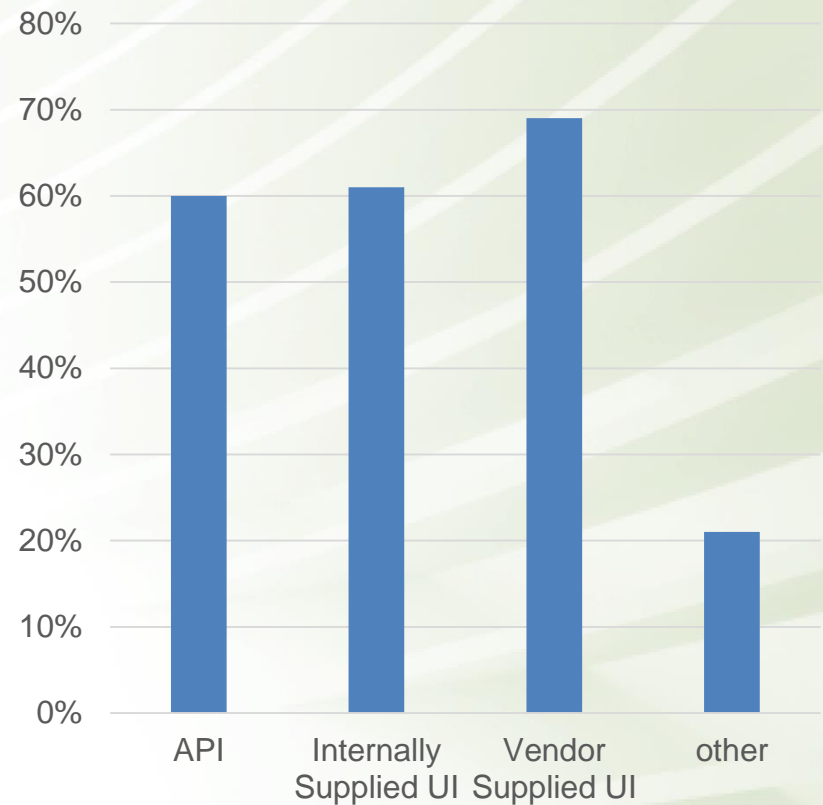
Support for Document Repository by FI Asset Size

Document Repository

FI Asset Size	Yes	No	Don't know
Under $500m (12)	75%		25%
$500m-$5b (24)	96%		4%
$5b-$25b (9)	78%		22%
$25b-$100b (12)	50%	17%	33%
Over $100b (19)	53%	5%	42%

Legend: ■ Yes ■ No ■ Don't know

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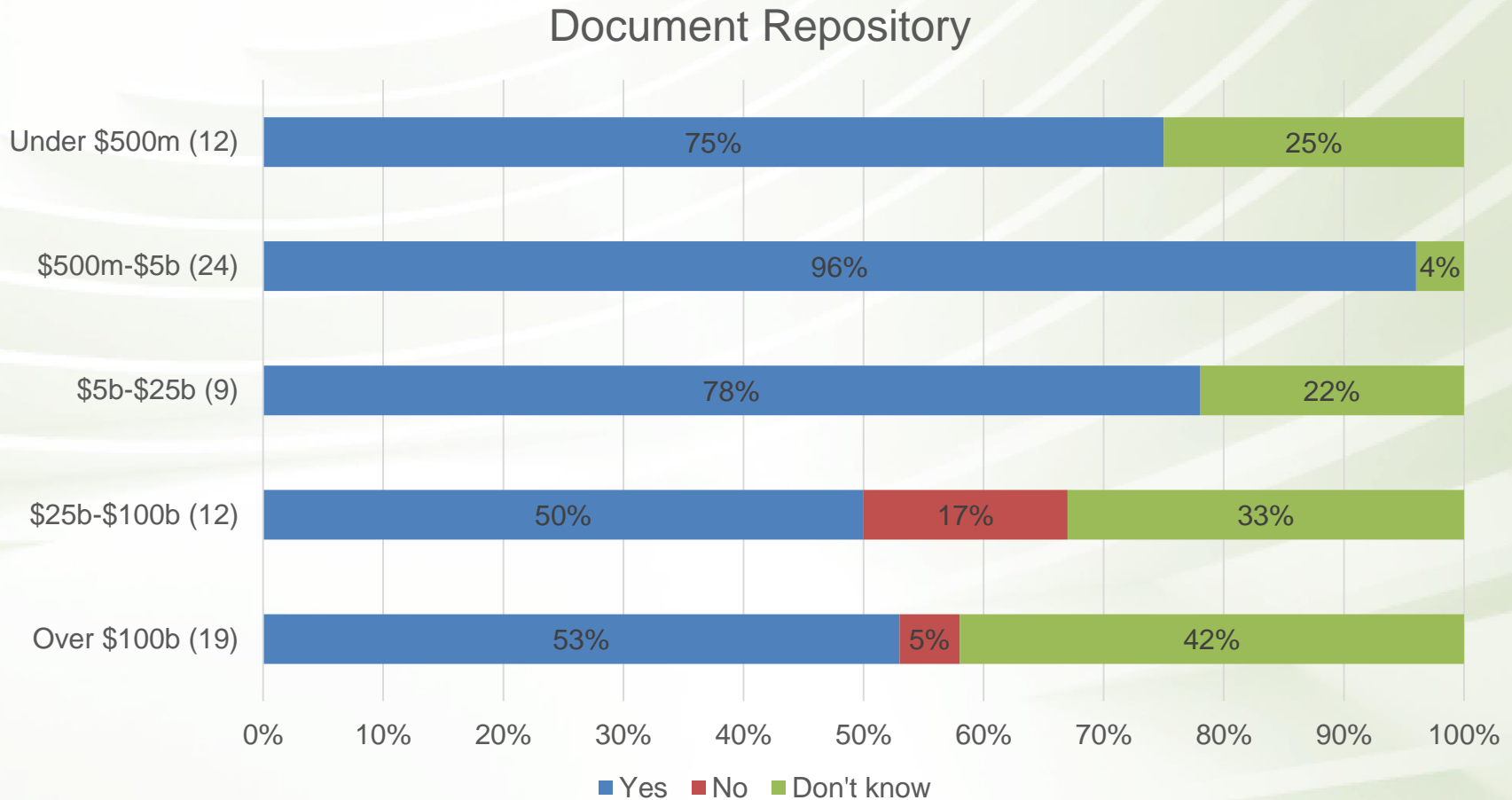
Responses - Implementation

- Does your institution agree that ACH Message Entries should have a single implementation?
  - 54% Yes
  - 30% No
  - 15% Don't Know
  - 1% No Opinion

  - TPSP/Vendors:
    - 20% Yes
    - 20% No
    - 40% Don't Know
    - 20% No Opinion

Next Steps

- Staff and rules work groups will continue to analyze the RFC responses.
  - Particular focus will be spent on:
    - Document repository functionality
    - Implementation strategy

ACH Audit and Risk Management Topics

REQUESTS FOR COMMENT

Recent RFCs

- Two Requests for Comment were issued May 11
  - ACH Quality and Risk Management Topics
    - 83 responses received
  - ACH Rules Compliance Audit Requirements
    - 65 responses received

- Responses from the industry were originally requested by Friday, June 29, 2018 – extended to July 20, 2018
  - Information included in this deck relates to responses received as of the morning of July 23, additional responses are expected to be received

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ACH Quality and Risk Management RFC

- This Request for Comment included several new topics to help manage risk and improve quality

  1. Limiting the length of time an RDFI can make a claim against an ODFI's authorization warranty

  2. Differentiating among types of unauthorized returns

  3. Supplementing the fraud detection standard for Internet-initiated (WEB) debits

  4. Allowing RDFIs to indicate within a return that the original transaction was questionable or part of anomalous activity

  5. Supplementing the existing account information security requirements for large Originators and Third-Parties

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RDFI Warranty Claims – Rule Proposal

- The proposed rule change would limit the length of time in which an RDFI would be permitted to make a claim against the ODFI's authorization warranty
  - For an entry to a non-consumer account, the time limit would be one year from the settlement date
    - This is analogous to the one-year rule in UCC §4-406 that applies to checks and items charged to bank accounts
  - For an entry to a consumer account, the time limit would be 18 months from the settlement date
    - This is intended to exceed the one-year Statute of Limitations in the Electronic Funds Transfer Act (covering Regulation E claims), which runs from the date of the occurrence of the violation, which may be later than the settlement date of the transaction
    - This also allows for "extenuating circumstances" in which a consumer is delayed from reporting an error to his or her financial institution
    - RDFIs generally would still be enabled to recover amounts they must pay consumers under Regulation E
    - There may be a small increase to the risk that an RDFI could be liable to its customer without the ability to collect from the ODFI

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RDFI Warranty Claims

- Majority of respondents indicated overall support for limiting the time period an RDFI can make a claim against an ODFI's authorization warranty

- Support limiting the time frame related to non-consumer accounts to one year was split

- Support for limiting the time frame related to consumer accounts to eighteen months was split
    - Strongest support for other times was for one year

Differentiating Unauthorized Return Reasons – Rule Proposal

- A different return code (R11) would be re-purposed to be used for a transaction in which there is an error, but for which there is an authorization
  - R11 volume is currently very low – only 345 total returns in 2017, none of which are related to its original purpose to return check truncation entries
  - The re-purposed reason would be "Customer Advises Entry Not In Accordance with the Terms of the Authorization"
  - The new R11 would have the same 60-day extended return time frame and requirement for a Written Statement as currently with R10
  - These returns would continue to be covered by the Unauthorized Entry Return Rate and Unauthorized Entry Fee definitions as currently with R10

- Return reason code R10 would continue to be used when a consumer claims he or she does not know the Originator, does not have a relationship with the Originator, or did not give authorization for the account to be debited
  - "Customer Advises Originator is Not Known to Receiver and/or Is Not Authorized by Receiver to Debit Receiver's Account"

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Differentiating types of unauthorized returns

- Many respondents generally agree with the proposal to better differentiate unauthorized returns

- Nearly all who support the overall proposal also support re-purposing Return Reason Code R11 for returns for errors and defects and continuing to use R10 when there is no relationship/authorization

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Commercially Reasonable Fraud Detection – Rule Proposal

- The current screening requirement would be supplemented to make it explicit that "account validation" is an inherent part of a "commercially reasonable fraudulent transaction detection system"
  - Existing NACHA guidance already states
    - "An important element of a commercially reasonable fraudulent transaction detection system would be the adoption of risk-based mechanisms designed to confirm the validity of an account to be debited."
  - The supplemental requirement would apply to the first use of an account number, or changes to the account number
  - The proposal is neutral with regard to specific methods or technologies to validate account information. Possibilities include
    - An ACH prenotification
    - ACH micro-transaction verification
    - Commercially available validation service
  - Doing nothing to validate account information on its first use or for changes would be deemed not commercially reasonable

Commercially Reasonable Fraud Detection – Rule Proposal

- Additionally, the current screening requirement would be further supplemented to require the dollar amount of the WEB debit to reasonably relate to the purpose of the payment
  - Such "reasonableness testing" could screen for large overpayments or irregular payment amounts. For example
    - A large overpayment of an amount due on a bill, loan, or other obligation
    - A large, atypical amount of an account-to-account transfer
    - Mis-keying by a customer of an amount to pay or transfer that results in a large overpayment

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Commercially reasonable fraudulent transaction detecting – account validation and dollar-amount reasonableness testing

- Support was expressed for an addition that "account validation" should be part of a commercially reasonable fraudulent detection system for screening WEB debits
  - Most of those respondents agree that account validation should be conducted for the first use of an account number, and for any subsequent change(s) to the account number, in originating WEB debits

- Less support was expressed for the proposal that a commercially reasonable fraudulent transaction detection system should reasonably relate the dollar amount of the debit WEB entry to the purpose of the debit

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Allow a Return for Questionable Activity – Rule Proposal

- RDFIs would be allowed (but not required) to use return reason code R17 to indicate that the RDFI believes the entry was initiated under questionable circumstances
  - RDFIs electing to use R17 for this purpose would be required to use the description "QUESTIONABLE" in the Addenda Information field of the return
  - An R17 in conjunction with this description would enable these returns to be differentiated from returns for routine account numbers errors
- Currently, return reason code R17 is used in NACHA-coordinated opt-in programs with federal and state tax agencies for RDFIs to return tax refund ACH credits that RDFIs believe are questionable
- Additionally, existing NACHA guidance advises RDFIs that they can use R17 to return questionable transactions that would otherwise be returned via existing invalid/no account return codes (R03/R04)

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Account Information Security – Rules Proposal

- The proposal would expand the existing ACH Security Framework rules to explicitly require large, non-FI Originators, Third-Party Service Providers (TPSPs) and Third-Party Senders (TPSs) to protect deposit account information by rendering it unreadable when it is stored <u>electronically</u>
  - Aligns with existing requirement and language contained in PCI; industry participants should be reasonably familiar with manner and intent of requirement
  - Neutral as to methods/technology – encryption, truncation, tokenization, destruction; data stored/hosted/tokenized by ODFI, etc.
  - Would apply only to the deposit account number collected for or used in ACH transactions
    - Would not apply to the storage of paper authorizations
  - Financial institutions as internal Originators are covered by existing FFIEC and similar data security requirements and regulations
- Originators and TPSPs covered by the rule would be required to attest compliance to their ODFI (or for TPSPs and TPS, if applicable, to their counterparty with whom they have their agreement to originate or transmit ACH entries)
  - The proposed rule would be a direct obligation of Originators and TPSPs; ODFIs would not be required to ensure, verify, audit or warrant compliance of their Originators/TPSPs

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Account Information Security – Rules Proposal

- Implementation would begin with the largest Originators and TPSPs (including TPSs)
  - The rule would initially apply to ACH Originators/TPSPs/TPSs with ACH volume of 6 million transactions or greater annually
    - Initially, an Originator/Third-Party that originated 6 million or more ACH transactions in calendar year 2018 would need to be compliant and attest by June 30, 2019
  - A second phase would apply to ACH Originators/TPSPs/TPSs with ACH volume of 2 million transactions or greater annually
    - An Originator/Third-Party that originated 2 million or more ACH transactions in calendar year 2019 would need to be compliant and attest by June 30, 2020
  - Many ACH Originators/TPSPs are likely compliant already, particularly those that comply with similar PCI requirements

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Questionable Activity Returns and AIS

- Strong support for the proposal to allow RDFIs to use R17 in situations when the RDFI has reason to believe that an entry with invalid or closed account information is part of questionable or anomalous activity

- Strong support also shown for the proposal to supplement the existing ACH Security Framework rules to explicitly require large non-FI Originators and Third Party Service Providers (including Third-Party Senders) to protect DDA information used in ACH transactions by rendering it unreadable when it is stored electronically

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Next Steps

- The Risk and Quality RFC included various implementation dates by topic
  - Support was mixed for the proposed dates
  - Implementation dates will be evaluated along with other Rules proposals dates

- Next step: NACHA staff will compile summaries of the responses to each RFC for the SRG to review and suggest next steps

ACH Rules Compliance Audit Proposal

- Purpose – Simplify the Rules and the Rulebook with respect to the Audit
- Proposal – Remove Appendix Eight and all its prescribed audit topics in their entirety from the Rules
  - Move those topics, in less prescriptive language, to the Guidelines
    - Consolidate all audit references to one location in the Guidelines instead of multiple locations
  - Makes it easier to update language on audit topics as the ACH Network and operating environment change
    - Eliminates need to amend the audit methodology via the Rules process
  - Can reference other items in the Guidelines that are not directly covered by the Rules
  - Many RPAs already offer audit workbooks
- Does not change audit requirements, only the structure in Rules
  - General audit obligation, deadline, and proof of completion still defined in Rules

- The language changes are proposed to become effective on January 1, 2019 to apply to audits required to be conducted by December 31, 2019.

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ACH Rules Compliance Audit RFC

- Strong support for moving the Appendix Eight introduction and Part 8.1 into the existing audit discussion of Article One, Section 1.2.2 (Audits of Rules Compliance) and moving the prescribed list of topics in Appendix Eight from the *Rules* and into the *Guidelines* to be included as guidance for performing the annual ACH rules compliance audit

- Majority support the proposed effective date of January 1, 2019 to apply to audits due by December 31, 2019.
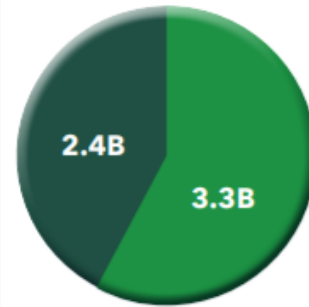
Resource

ACH NETWORK VOLUME UPDATE

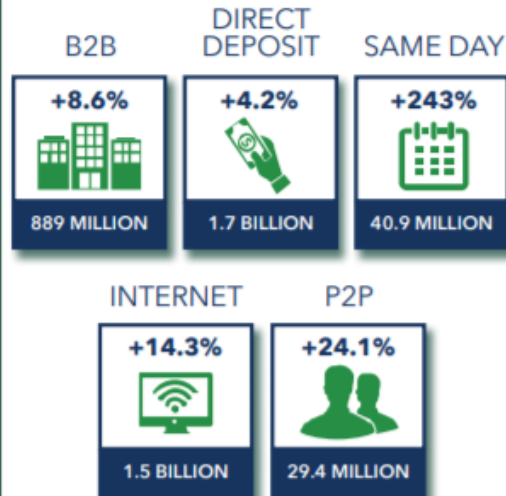# 2Q 2018 ACH NETWORK VOLUME TOTALS 5.7 BILLION

VOLUME GREW
332M   6.2%
OVER 2Q 2017

2Q 2018 VOLUME
2.4B   3.3B

- DEBIT
- CREDIT

SAME DAY ACH VOLUME INCREASED 243% OVER 2Q 2017

40.9M — 2Q18
11.9M — 2Q17

VOLUME INCREASED ACROSS MAJOR TRANSACTION TYPES COMPARED TO 2Q 2017

	B2B	DIRECT DEPOSIT	SAME DAY
	+8.6%	+4.2%	+243%
	889 MILLION	1.7 BILLION	40.9 MILLION

	INTERNET	P2P
	+14.3%	+24.1%
	1.5 BILLION	29.4 MILLION

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Thank You!

amorris@nacha.org

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